DEPARTMENT OF STATE REVNUE
LETTER OF FINDINGS: 02-0082
GROSS INCOME TAX
For the 1998 Tax Year

NOTICE: Under IC 5-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of the document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Non-Profit Water & Sewer Utility Cooperative – Gross Income Tax.

Authority: IC 6-2.1-1-2(a); IC 6-2.1-1-16(17); IC 6-2.1-3-19; IC 6-2.1-3-19(b); IC 6-2.1-3-20; IC 6-2.1-3-21; IC 6-2.1-3-22; IC 6-2.1-3-33; IC 6-8.1-3-3; Department of Revenue Information Bulletin 73 (1988, 2001).

Taxpayer argues that, because it is a not-for-profit utility cooperative, it was not responsible for paying the state's gross income tax. Further, taxpayer maintains that it was not required to file for a not-for profit exemption certificate with the state in order to qualify for that exemption.

II. Prospective Treatment of Taxpayer's Gross Income Tax Liability.

Authority: IC 6-8.1-3-3; IC 6-8.1-3-3(b); City Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind. Tax Ct. 1998); West Publishing Co. v. Indiana Dept. of Revenue, 524 N.E.2d 1329 (Ind. Tax Ct. 1988); Black's Law Dictionary (7th ed. 1999).

Taxpayer is requesting that any determination as to its gross income tax liability be applied on a prospective basis. Taxpayer maintains that it is entitled to this treatment because its past failure to pay gross income tax was based on excusable neglect and that the Department is estopped from, at this late date, assessing gross income tax liability.

III. Abatement of the Ten-Percent Negligence Penalty.

Authority: IC 6-2.1-3-19(b); IC 6-8.1-10-2.1; IC 6-8.1-10-2.1(d); 45 IAC 15-11-2(b); 45 IAC 15-11-2(c).

Taxpayer asks that the Department exercise its discretion to abate the ten-percent negligence penalty; taxpayer maintains that failure to pay the tax was due to "excusable neglect" and was not due to the taxpayer's negligence.

STATEMENT OF FACTS

Taxpayer was formed in 1991 as a water and sewer utility cooperative. Currently, taxpayer serves about 800 customers and has two part-time employees. From the date of its formation until 1993, the taxpayer filed Indiana Corporation Income Tax returns. The taxpayer continued to file a federal not-for-profit return until 1998. However, taxpayer never filed for or received a "not-for-profit" designation from the Department.

Because the taxpayer sold a portion of its business in 1998, taxpayer filed a federal 1120 return for that year. Taxpayer filed the 1120 return because – having sold a portion of its business – taxpayer received a sufficient amount of unrelated business income to disqualify it from filing a 1998 federal not-for-profit return.

The Department of Revenue conducted an audit of taxpayer's 1998 business records. This audit resulted in the assessment of gross income taxes. In the belief that it was entitled to an exemption from those taxes, taxpayer submitted a protest. An administrative hearing was held, and this Letter of Findings was prepared.

I. Non-Profit Water & Sewer Utility Cooperative – Gross Income Tax.

In 1993, IC 6-2.1-3-33 was amended to read, in part as follows: "Gross income received by . . . (5) A not-for-profit corporation formed for the purpose of providing a combination of; (A) Water; and (B) Sewer and sewage service; to the public; is exempt from gross income tax." In the apparent belief that it qualified as a "not-for-profit corporation," taxpayer stopped filing Indiana income tax returns.

The audit disagreed with taxpayer's conclusion and – despite the plain language of IC 6-2.1-3-33 – assessed taxpayer for gross income taxes on the ground that taxpayer had failed to receive from the Department a formal designation as a "not-for-profit corporation."

The taxpayer argues that the Department is exceeding its authority in requiring that it file for and receive such a designation. Taxpayer bases its argument on an interpretative application of the language of IC 6-2.1-3-19, IC 6-2.1-3-20, IC 6-2.1-3-21, and IC 6-2.1-3-22, which each grant a similar exemption to various other qualifying organizations such as fraternities, churches, social organizations, and hospitals. Taxpayer points out that, in each of those four statutory exemption statutes, there is found explicit language requiring that the putative exempt organization to file for and receive a not-for-profit exemption. *See* IC 6-2.1-3-19(b).

In the taxpayer's view, because there is no such explicit requirement found within IC 6-2.1-3-33, it was simply – on the basis of its own say-so – entitled to designate itself as a qualifying not-for-profit organization. In the Department's view, the taxpayer is required to be "registered as a not-for-profit corporation with the Indiana Department of Revenue." Department of Revenue Information Bulletin 73, September 2001.

The legislature has vested the Department with broad authority to implement and interpret the state's tax laws. IC 6-8.1-3-3 requires that the Department adopt regulations "governing; (1) the administration, collection, and enforcement of the listed taxes; (2) the interpretation of the statutes governing the listed taxes; (3) the procedures relating to the listed taxes . . . ."

Clearly, IC 6-2.1-3-33 grants not-for-profit water and sewer companies an exemption from the gross income tax. However, just as plainly, the tax is imposed on "all the 'gross receipts' a taxpayer receives . . . from trades, business or commerce" (IC 6-2.1-1-2(a)) and that a "cooperative association," such as the taxpayer, qualifies as a "taxpayer." IC 6-2.1-1-16(17). It follows then, that there are water and sewer cooperatives which are subject to the gross income tax and that there are also water and sewer cooperatives that are not-for-profit ventures qualifying for the exemption provided under IC 6-2.1-3-33. The Department, in attempting to distinguish between the two, has adopted certain procedures which require that the entity "submit an application to file as a not-for-profit organization, Form IT-35A." Department of Revenue Information Bulletin 73, September 2001. *See also* Information Bulletin 73, 1988.

There is no indication that the Department exceeded its authority in requiring that the taxpayer apply for and actually receive a designation as a not-for-profit organization. Given that certain water and sewer cooperatives would not qualify for the designation; that certain water and sewer cooperatives would apply for and be denied the designation; and that a limited number of water and sewer cooperatives would qualify to receive the exemption, taxpayer's argument – that it was entitled to self-designate itself as a qualifying organization – fails.

However, even if the taxpayer had filed for and received a designation as a not-for-profit Indiana corporation, that designation would not have precluded the Department from assessing the 1998 income taxes. In order to qualify as a not-for-profit corporation, the state requires that "[t]he corporation . . . qualify for exemption under Section 501 of the Internal Revenue Code . . . ." Department of Revenue Information Bulletin 73, September 2001. *See also* Information Bulletin 73, 1988. From the available information, it is apparent that taxpayer – having sold a portion of its business and realized substantial income as a result of that sale – no longer qualified as a not-for-profit organization under the Internal Revenue Code. Because taxpayer no longer qualified as a federal not-for-profit organization, it would not have qualified under the state's own rules.

In addition, even if the taxpayer would have qualified for the exemption provided under IC 6-2.1-3-33, there is no indication that it filed the requisite "Annual Gross Income Tax Exemption Report" (IT-35AR) necessary for a qualifying taxpayer to retain its exempt status. There is no indication that taxpayer, having realized "unrelated business income" from the sale of a portion of its business, reported that income on a "Not-For-Profit Organization Income Tax Return." (IT-20NP).

FINDING

Taxpayer's protest is respectfully denied.

II. Prospective Treatment of Taxpayer's Gross Income Tax Liability.

Alternatively, taxpayer argues that it is entitled to prospective treatment of the Department's determination that it is subject to the gross income tax.

Under IC 6-8.1-3-3, the Department of Revenue is without authority to reinterpret a taxpayer's tax liability without promulgating and publishing a regulation giving taxpayer notice of that reinterpretation. IC 6-8.1-3-3(b) states that "[n]o change in the department's interpretation of a listed tax may take effect before the date the change is (1) adopted in a rule under this section or (2) published in the Indiana Register . . . ."

In City Securities Corp. v. Dept. of State Revenue, 704 N.E.2d 1122 (Ind. Tax Ct. 1998), the tax court found that that – despite the adoption of intervening regulations to the contrary – the Department could not impose additional gross income tax on the gain realized from the sale of tax-exempt bonds because the Department had allowed the plaintiff taxpayer to continue claiming an exemption subsequent to the adoption of the regulations disallowing the exemption. Id. at 1129. Having permitted the plaintiff taxpayer to treat the income as exempt for approximately 42 years, the Department was estopped from reaching back to the time the intervening regulations were adopted and assess an additional gross income tax liability against the plaintiff taxpayer. Id. at 1128-29.

However, unlike the plaintiff taxpayer in City Securities, taxpayer has failed to provide a critical element necessary to establish the estoppel defense. In order to establish that defense, taxpayer must demonstrate that "the person to be estopped has induced another person to act in a certain way, with the result that the other person has been injured in some way." Black's Law Dictionary 571 (7th ed. 1999). The taxpayer has failed to establish that the Department – by word, deed, or writing – in any way induced the taxpayer into believing that the taxpayer could unilaterally grant itself not-for-profit status or that the taxpayer was not required to apply for and receive a not-for-profit designation as a qualified water and sewer cooperative. "The state will not be estopped in the absence of clear evidence that its agents *made* representations upon which the party asserting estoppel relied." West Publishing Co. v. Indiana Dept. of Revenue, 524 N.E.2d 1329, 1333 (Ind. Tax Ct. 1988) (*Emphasis added*).

The taxpayer's current quandary appears to be entirely of its own making, and was arrived at without any assistance from the Department.

FINDING

Taxpayer's protest is respectfully denied.

III. Abatement of the Ten-Percent Negligence Penalty.

Taxpayer argues that its failure to pay the gross income tax deficiency was not due to its own neglect and that it is justified in requesting that the Department exercise its discretion to abate the

10 percent negligence penalty. Further, taxpayer maintains that the negligence penalty should be abated under the "excusable neglect" defense found under IC 6-2.1-3-19(b).

IC 6-8.1-10-2.1 requires that a ten-percent penalty be imposed if the tax deficiency results from the taxpayer's negligence. Departmental regulation 45 IAC 15-11-2(b) defines negligence as "the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer." Negligence is to "be determined on a case-by-case basis according to the facts and circumstances of each taxpayer." Id.

IC 6-8.1-10-2.1(d) allows the Department to waive the penalty upon a showing that the failure to pay the deficiency was based on "reasonable cause and not due to willful neglect." Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . ."

Taxpayer has failed to demonstrate that its initial decisions – concerning its not-for-profit status and the resultant gross income tax consequences – were arrived at through the exercise of "ordinary business care and prudence." In addition, the taxpayer is not entitled to invoke the "excusable neglect" defense under IC 6-2.1-3-19(b) That particular defense is available to those not-for-profit taxpayers who fail to submit the mandatory annual report by May 15 and who, as a result, have their tax exempt status cancelled. When the otherwise qualifying taxpayer has failed to file the annual report due to "excusable neglect," the Department is required to reinstate the exemption. The "excusable neglect" defense has no relevance to the 10 percent negligence penalty imposed under IC 6-8.1-10-2.1.

FINDING

Taxpayer's protest is respectfully denied.

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